

# Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the City of Mbombela Local Municipality

## Report on the audit of the financial statements

### Opinion

1. I have audited the financial statements of the City of Mbombela Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the City of Mbombela Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (Dora).

### Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### Material uncertainty related to financial sustainability

6. I draw attention to the matter below. My opinion is not modified in respect of this matter.

7. I draw attention to note 59 to the financial statements, which indicates that the municipality incurred a net loss of R184 489 932 (2016-17: R152 057 316) for the year ended 30 June 2018 and, as of 30 June 2018, the municipality's current liabilities exceeded its current assets by R1 276 448 761 (2016-17: R1 119 554 252). As stated in note 59, these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the financial sustainability of the municipality.

### **Emphasis of matters**

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Restatement of corresponding figures**

9. As disclosed in note 45 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2018.

### **Material impairments – trade debtors**

10. As disclosed in notes 4 and 7 to the financial statements, the receivables balance was significantly impaired. The total impairment of receivables amounted to R230 985 330 (2016-17: R383 103 768), which represented 56% (2016-17: 65%) of the total receivables. The reversal to the provision for debt impairment was R78 227 926 (2016-17: R97 896 778 contribution).

### **Material losses – electricity**

11. As disclosed in note 50 to the financial statements, material electricity losses of R106 030 614 (2016-17: R73 666 512) were incurred, which represented 16% (2016-17: 14,37%) of the total electricity purchased.

### **Material losses – water**

12. As disclosed in note 50 to the financial statements, material water losses of R4 731 946 (2016-17: R3 904 177) were incurred, which represented 20,5% (2016-17: 20,36%) of the total water pumped.

### **Events after reporting date**

13. As disclosed in note 60 to the financial statements, grant funding amounting to R148,6 million was not approved for rollover by the National Treasury.
14. As disclosed in note 60 to the financial statements, irregular expenditure incurred in prior years amounting to R1,1 billion was approved for write-off by the council.

### **Unauthorised, irregular, and fruitless and wasteful expenditure**

15. As disclosed in note 52 to the financial statements, the municipality incurred unauthorised expenditure of R319 607 707, due to the overspending of the approved operational budget.
16. As disclosed in note 53 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R28 909 554, due to interest charges on overdue accounts.
17. As disclosed in note 54 to the financial statements, the municipality incurred irregular expenditure of R186 520 982, as it did not follow proper procurement and contract management processes.

### **Other matters**

18. I draw attention to the matters below. My opinion is not modified in respect of these matters.

### **Considerations for withdrawal from the audit engagement**

19. Specific inconsistencies identified in some of the evidence provided during the audit raise significant concern about the integrity, ethical conduct or diligence of the officials who are responsible for the preparation of such evidence, which calls into question the reliability and the genuineness of the evidence obtained. I would have withdrawn from the engagement in terms of the ISAs; however, the legislated requirements to perform the statutory audit of the municipality do not permit this.

### **Unaudited disclosure note**

20. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

### **Responsibilities of the accounting officer for the financial statements**

21. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
22. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

## **Auditor-general's responsibilities for the audit of the financial statements**

23. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
24. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

## **Report on the audit of the annual performance report**

### **Introduction and scope**

25. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
26. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
27. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2018:

<b>Development priorities</b>	<b>Pages in the annual performance report</b>
Development priority 1.1 – water supply	xx – xx
Development priority 1.2 – sanitation	xx – xx
Development priority 1.3 – electricity supply management	xx – xx
Development priority 1.4 – roads and storm water management	xx – xx
Development priority 1.5 – public transport	xx – xx
Development priority 1.7 – waste and environmental management	xx – xx

28. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the usefulness and reliability of the selected development priorities are as follows:

#### **Development priority 1.1 – water supply**

##### **Performance indicators not well defined and targets not specific or measurable**

###### **Number of components refurbished**

30. The planned target for this indicator was not specific in clearly identifying the components to be refurbished.

###### **Number of reservoirs for Barberton constructed**

31. The planned target for this indicator was not specific in clearly identifying the nature and the required level of performance. The target was also not measurable.
32. I did not identify any material findings on the usefulness and reliability of the reported performance information for the following development priorities:
- Development priority 1.2 – sanitation
  - Development priority 1.3 – electricity supply management
  - Development priority 1.4 – roads and storm water management
  - Development priority 1.5 – public transport
  - Development priority 1.7 – waste and environmental management

#### **Other matters**

33. I draw attention to the matters below.

###### **Achievement of planned targets**

34. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year and explanations provided for the underachievement of a significant number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 30 to 31 of this report.

## Adjustment of material misstatements

35. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of development priority 1.1 – water supply and development priority 1.5 – public transport. As management subsequently corrected only some of the misstatements, I raised material findings on the reliability of the reported performance information. Those that were not corrected are reported above.

## Report on the audit of compliance with legislation

### Introduction and scope

36. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
37. The material findings on compliance with specific matters in key legislation are as follows:

### Annual financial statements, performance report and annual report

38. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of current assets and liabilities identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

### Expenditure management

39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
40. Reasonable steps were not taken to prevent irregular expenditure amounting to R186 520 982, as disclosed in note 54 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the irregular expenditure was caused by procuring services through the extension of contracts rather than by inviting competitive bids.
41. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R28 909 554, as disclosed in note 53 to the financial statements, in contravention of section 62(1)(d) of the MFMA. All of the disclosed fruitless and wasteful expenditure was caused by interest charged on overdue trade payables; a significant portion of which was incurred on Eskom debt.

42. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R319 607 707, as disclosed in note 52 to the financial statements, in contravention of section 62(1)(d) of the MFMA. All of the unauthorised expenditure was caused by the overspending of the operational budget.

#### **Procurement and contract management**

43. Goods and services with a transaction value above R200 000 were procured through multiple extensions of contracts rather than by inviting competitive bids, contrary to supply chain management regulation 19(a).
44. Some of the commodities designated for local content and production were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by preferential procurement regulation 8(5) of 2017. Similar non-compliance was also reported in the prior year.

#### **Other information**

45. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in this auditor's report.
46. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
47. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
48. I have nothing to report in this regard.

#### **Internal control deficiencies**

49. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.
50. The municipality did not have sufficient monitoring controls to prevent unauthorised, irregular, and fruitless and wasteful expenditure.

51. The recording, review and reporting processes and controls over current assets and liabilities, operating expenditure and disclosure notes to the financial statements were not adequate.
52. The recording, review and reporting processes and controls over the actual achievement of planned targets reported in the annual performance report were not adequate.
53. Non-compliance with legislation could have been prevented had compliance been properly reviewed and monitored.

*Auditor General*

Mbombela

30 November 2018



AUDITOR - GENERAL  
SOUTH AFRICA

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## **Annexure – Auditor-general's responsibility for the audit**

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality's compliance with respect to the selected subject matters.

### **Financial statements**

2. In addition to my responsibility for the audit of the financial statements as described in the auditor's report, I also:
  - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
  - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
  - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
  - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease continuing as a going concern
  - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

### **Communication with those charged with governance**

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.